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FISCAL IMPACT STATEMENT

LS 6278

BILL NUMBER: HB 1020

NOTE PREPARED: Dec 6, 2012

BILL AMENDED:

SUBJECT: New Markets Job Growth Income Tax Credit.

FIRST AUTHOR: Rep. Messmer

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: This bill establishes a New Markets Job Growth Credit against state tax liability for investments made by a taxpayer in a qualified community development entity that then uses the proceeds of the investment to make investments in certain qualified low-income community businesses located in Indiana. It specifies that the tax credit is equal to an applicable percentage multiplied by the purchase price of the qualified investment. It provides that the applicable percentage is: (1) 0% for the first and second credit allowance dates; (2) 7% for the third credit allowance date; and (3) 8% for the fourth, fifth, sixth, and seventh credit allowance dates.

The bill provides that a taxpayer is not entitled to a carry-back or refund of an unused tax credit, but the taxpayer may carry over excess credit amounts for not more than five subsequent taxable years.

This bill requires the Indiana Economic Development Corporation (IEDC) to limit the monetary amount of qualified equity investments to an amount necessary to limit the claiming of the tax credit to not more than \$20 M in any state fiscal year. The limit is based on the anticipated use of the tax credits without regard to the potential for taxpayers to carry forward tax credits to later tax years.

(The introduced version of the bill was prepared by the Interim Study Committee on Economic Development.)

Effective Date: January 1, 2014.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur some administrative expenses relating to the revision of the tax form instructions and software programs to

implement this bill. The DOR's current level of resources should be sufficient to implement the program.

Indiana Economic Development Corporation (IEDC): The IEDC will incur additional expenses to establish this program. They will be required to develop an application, process applications, certify community investments, and monitor investment projects. The IEDC's current level of resources should be sufficient to implement the program.

Explanation of State Revenues: Summary- The New Markets Job Growth Income Tax Credit (NMJG) is designed to attract private investments in economically distressed neighborhoods. The total credit equals 39% of the qualified equity investment (QEI) and is claimed over a seven-year period. Each year, the taxpayer applies the appropriate percentage to the QEI to determine the annual credit amount:

- 0% for the first and second year
- 7% for the third year
- 8% for the fourth, fifth, sixth, and seventh year

The bill goes into effect in CY 2014. NMJG credits can be awarded for QEIs made in that year. The fiscal impact of credits awarded in CY 2014 will occur in FY 2017 due to the applicable percentage tiers. The estimated cost of the credit in FY 2017 is approximately \$4.3 M and \$9.2 M in FY 2018. The usage of the credit will continue to grow until it reaches full utilization of \$20 M per fiscal year.

The credit can be used to offset tax liabilities from the Individual Adjusted Gross Income Tax, Corporate Adjusted Gross Income Tax, Financial Institutions Tax, and Insurance Premiums Tax. Revenue collected from those taxes are deposited in the General Fund. The revenue to the state General Fund would be reduced by the amount of the credits.

The credits are nonrefundable, but the taxpayer may carry forward unused balances for up to five years. In addition, IEDC must limit the amount of QEIs so the total NMJG credits do not exceed \$20 M in any fiscal year. This limit is based on the anticipated use of the credits. The IEDC does not have to take into account taxpayers who may be carrying forward tax credits.

Background - Ball State University, Center for Business and Economic Research, conducted a study on the effectiveness of the federal New Markets Tax Credit Program (NMTC) and how a state-level version of the NMTC affected overall levels of investment. The study found that states with their own version of a New Markets Tax Credit had higher levels of NMTC investments. They ran a simulation on the impact of Indiana implementing a 39% state version of the NMTC. The simulation estimated that an Indiana NMTC would attract \$433 M dollars in investments over a seven-year period.

Assuming Indiana attracts a total of \$61 M a year in qualifying investments beginning in CY 2014, the first year the NMJC credits for those investments may be used to offset a tax liability is FY 2017. This is due to the applicable credit percentage tiers.

The NMJC tax credit amount is spread over a seven-year period. The taxpayer may not use the NMJC credit for the first two years following the qualifying investment. Then, the credit equals 7% of the qualifying investment in year three and 8% of the qualifying investment in year four, five, six, and seven. So, the last year an NMJC tax credit could be claimed for a qualifying investment made in CY 2014 would be FY 2021.

Applying the applicable credit percentage tiers to an estimated annual amount of qualifying investment of \$61 M, the estimated cost of the NMJC tax credit is \$4.2 M in FY 2017 and \$9.2 M in FY 2018. Under these assumptions, the annual fiscal year limit of \$20 M in NMJC credits would be reached in FY 2021 after five years of qualifying investments.

Additional Background-Federal New Markets Tax Credit Program: This bill is based on the NMTC Program. This was enacted by Congress as part of the Community Renewal Tax Relief Act of 2000 and is incorporated as section 45D of the Internal Revenue Code. This Code section permits individual and corporate taxpayers to receive a credit against federal income taxes for making qualified equity investments (QEIs) in qualified community development entities (CDEs).

These investments are expected to result in the creation of jobs and material improvement in the lives of residents of low-income communities. Examples of expected projects include financing small business, improving community facilities such as daycare centers, and increasing home ownership opportunities. The Indiana NMJC uses the same language to determine a qualifying project except the Indiana program excludes charter schools and businesses who derive over 15% of their annual revenue through the rental or sale of real estate.

The actual cash investment made by the investor to the CDE, which is referred to as the equity investment, is the first step in defining a QEI. The cash investment eventually qualifies for the NMTC provided that the CDE makes qualified low-income community investments.

A QEI is, in general, any equity investment in a CDE if:

- Such investment is acquired by the investor at its original issue (directly or through an underwriter) solely in exchange for cash;
- Substantially all (at least 85%) of the cash is used by the CDE to make a qualified low-income community investments; and
- The investment is designated CDE as a QEI on its books and records using any reasonable method.

The term equity investment means any stock in an entity which is a corporation, and any capital interest in an entity which is a partnership. In general, an equity investment in a CDE is not eligible to be designated as a QEI if it is made before the CDE enters into an allocation agreement with the Community Development Financial Institutions Fund.

A taxpayer holding a qualified equity investment on a credit allowance date occurring during the taxable year may claim the NMTC for such taxable year in an amount equal to the applicable percentage of the original purchase price of the QEI. The credit period for the investment is the seven-year period beginning on the date a QEI is initially made, even though the credit is allowable on the first day of each credit year.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected:

Information Sources: Hicks, Michael J. And Dagney Faulk. “*The Effect of State-Level Add-On Legislation to Federal New Market Tax Credit Program.*” February 2012; Internal Revenue Service, “*New Markets Tax Credit.*” May 2010; Community Development Financial Institutions Fund, U.S. Department of the Treasury, http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5

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